

PETRO REEF RESOURCES LTD.**1995****ANNUAL REPORT**

REPORT TO THE SHAREHOLDERS

Petro-Reef Resources Ltd. is a junior crude oil and natural gas exploration and production company which trades on the Alberta Stock Exchange under the symbol PER.

The company continues to concentrate its efforts in the Morinville area north of Edmonton where multi-zone potential and an existing infrastructure of plants and pipelines make early cash flow possible. The company generates all its own prospects and operates where feasible.

The company drilled one prospect during fiscal year 1995 resulting in a dry and abandoned well. Previous successful wells drilled in 1994 have not been placed on stream to date, due to mechanical difficulties and production of sand with the oil. One of these wells which produced for five days prior to the difficulties was producing at rates of up to 300 barrels per day before the sand wore a hole in the tubing.

The company drilled a dry and abandoned well in March of 1996. It is anticipated that additional wells are to be drilled in 1996 after spring break-up.

The company will farm-out its prospects in the Morvinville area during 1996. Management does not wish to raise capital for drilling at the present low stock prices in order not to dilute the common shares of the company.

There are tax pools of approximately \$1,786,000 available against future taxable income.

Petro-Reef Resources Ltd. recorded a write-down of its property, plant, and equipment of \$783,500 as a result of the ceiling test calculation. The resulting asset value in the company was reduced to \$673,992 compared to an asset value of \$1,928,731 for 1994.

The asset value does not include reserves which may be added from the Cardiff property where the company has three capped gas wells and one standing suspended oil well. The company has an approximate forty per cent working interest in this property.

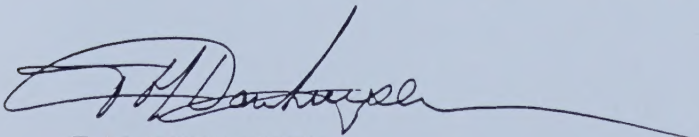
It is anticipated that with the successful completion of the above referenced capped and suspended wells, as well as the potentially successful wells to be drilled during the remainder of 1996, the asset base and net cash flow per share should increase significantly.

Gross revenues for fiscal year 1995 were \$36,713 versus \$102,208 for 1994, due to an extremely low gas price of \$1.08 per MCF. Average gas prices for the first three months of 1996 were \$1.59 per MCF.

Net loss for 1995 was \$936,588 versus \$9,996 for 1994 as a result of the low gas prices, the abnormal high production expenses which consisted of several one time charges, and the write-down of petroleum and natural gas properties which resulted in a depletion and depreciation expense of \$846,920 for 1995 versus \$35,660 for 1994.

On behalf of the Board of Directors, I would like to thank the shareholders for the continued support that you have shown to both the directors and management of Petro-Reef Resources Ltd. during a trying year.

Management will continue to endeavour to meet and exceed your expectations.



T. M. DONHUYSEN
President and C.E.O.

April 4, 1996
Calgary, Alberta

PETRO-REEF RESOURCES LTD.

CORPORATION INFORMATION

Directors and Officers

Theodore M. Donhuysen

Chief Executive Officer
President & Director
Calgary, Alberta

Joseph Werner

Chairman of the Board
Chief Financial Officer & Director
Calgary, Alberta

Gary W. Coleman

Director
Calgary, Alberta

Robert N. Maertens-Poole

Director
Calgary, Alberta

Douglas W. Schneider

Director
Calgary, Alberta

Head Office

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Legal Counsel and Corporate Secretary

R. Greg Powers
Calgary, Alberta

Bank

Hong Kong Bank of Canada

Auditors

Coopers & Lybrand

Registrar & Transfer Agent

The RM Trust Company
Calgary, Alberta

Stock Listing

The Alberta Stock Exchange
Symbol "PER"

PETRO-REEF RESOURCES LTD.

Financial Statements

For the Years Ended December 31, 1995 and 1994

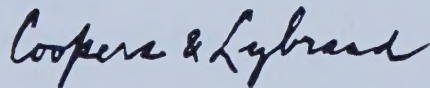
AUDITORS' REPORT

To the Shareholders of Petro-Reef Resources Ltd.

We have audited the balance sheets of Petro-Reef Resources Ltd. as at December 31, 1995 and 1994 and the statements of loss, deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1995 and 1994 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.



Chartered Accountants
Calgary, Alberta
February 21, 1996

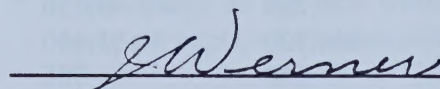
Petro-Reef Resources Ltd.

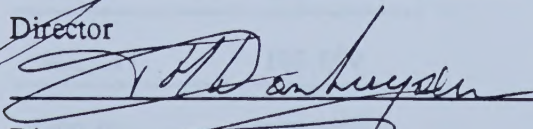
Balance Sheets

As at December 31, 1995 and 1994

	1995 \$	1994 \$ Restated (note 7)
ASSETS		
Current Assets		
Cash and short-term investments	9,462	730,217
Accounts receivable	12,215	139,427
Prepaid expenses and deposits	10,641	7,684
	32,318	877,328
Property, Plant and Equipment (note 2)	641,674	1,051,403
	673,992	1,928,731
LIABILITIES		
Current Liabilities		
Accounts payable and accrued charges	30,226	368,043
Future site abandonment cost	776	616
	31,002	368,659
SHAREHOLDERS' EQUITY		
Share Capital (note 3)	2,042,566	2,023,060
Deficit	(1,399,576)	(462,988)
	642,990	1,560,072
	673,992	1,928,731

SIGNED ON BEHALF OF THE BOARD


Director


Director

The accompanying notes form an integral part of these financial statements.

Coopers
& Lybrand

Petro-Reef Resources Ltd.

Statements of Deficit

For the Years Ended December 31, 1995 and 1994

	1995 \$	1994 \$
Deficit - Beginning of Year		
As previously reported	(462,988)	(462,992)
Correction of prior period error (note 7)	-	10,000
As restated	(462,988)	(452,992)
Net loss for the year	(936,588)	(9,996)
Deficit - End of Year	(1,399,576)	(462,988)

Petro-Reef Resources Ltd.

Statements of Loss

For the Years Ended December 31, 1995 and 1994

	1995 \$	1994 \$
Revenue		
Oil and gas sales	38,522	85,030
Royalties, net of Alberta Royalty Tax Credits	(10,875)	(5,022)
	27,647	80,008
Other Revenue	9,066	22,200
	36,713	102,208
Expenses		
Production	54,986	26,480
General and administrative	71,235	49,756
Depletion and depreciation	846,920	35,660
Provision for site restoration	160	308
	973,301	112,204
Net Loss for the Year	(936,588)	(9,996)
Basic and Fully Diluted Loss Per Common Share (note 1)	(0.08)	(0.00)

The accompanying notes form an integral part of these financial statements.

Petro-Reef Resources Ltd.

Statements of Changes in Financial Position

For the Years Ended December 31, 1995 and 1994

	1995 \$	1994 \$
Operating Activities		
Net loss for the year	(936,588)	(9,996)
Items not affecting working capital -		
Depletion and depreciation	846,920	35,660
Provision for site restoration	160	308
	(89,508)	25,972
Net change in non-cash working capital items related to operations *	(213,562)	229,327
	(303,070)	255,299
Financing Activities		
Issuance of common shares	20,000	663,252
Share issuance costs	(494)	(78,514)
	19,506	584,738
Investing Activities		
Expenditures on property, plant and equipment	(437,191)	(664,238)
Change in Cash During the Year	(720,755)	175,799
Cash - Beginning of Year	730,217	554,418
Cash - End of Year	9,462	730,217

* Net change in non-cash working capital related to operations is comprised of accounts receivable, prepaid expenses and deposits and accounts payable and accrued charges.

The accompanying notes form an integral part of these financial statements.

Coopers
& Lybrand

Petro-Reef Resources Ltd.

Notes to Financial Statements

For the Years Ended December 31, 1995 and 1994

1. Accounting Policies

Oil and gas operations

The company is engaged in the exploration for and development of oil and natural gas in Canada. Its activities are conducted jointly with other industry partners and accordingly, these financial statements reflect only the company's proportionate interest in such activities.

The company follows the full cost method of accounting for oil and gas operations whereby all costs related to the acquisition of, exploration for and development of oil and gas reserves are capitalized. Such costs include leasehold acquisition costs, geological and geophysical costs, lease rentals, drilling, plant and equipment costs and related overhead. Government incentives are credited to the cost of the oil and gas properties at the time the expenditures are incurred. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets with no gain or loss recognized, unless such a sale would result in a change of more than twenty percent in the depletion and depreciation rate.

In applying the full cost method, the company calculates a cost ceiling which restricts the capitalized costs less accumulated depletion from exceeding the estimated future net revenue from proved reserves, determined by independent reservoir engineers, based on year-end prices and production costs plus the net cost of undeveloped acreage, less future general and administrative expenses, financing costs, site restoration costs and income taxes (note 2).

Depletion is computed using the unit-of-production method based on gross estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content). In determining the appropriate depletion rate, the company considers the net book value of its proved oil and gas properties, as well as the estimated future costs to be incurred in developing proved reserves and abandoning depleted properties and the cost of undeveloped acreage.

Estimated costs of future abandonment and restoration of well sites and associated facilities are amortized over the life of the properties on a unit-of-production basis.

Depreciation

Depreciation of furniture and fixtures is calculated using the declining balance method at an annual rate of 20%.

Income taxes

The company follows the tax allocation method of accounting for income taxes whereby the income tax provision for the year is based on the income reported in the accounts. Under this method, the company provides for deferred income taxes as a result of claiming deductions for income tax purposes in excess of amounts claimed for financial statement purposes.

Petro-Reef Resources Ltd.

Notes to Financial Statements

For the Years Ended December 31, 1995 and 1994

Earnings Per Share

Earnings per common share are calculated using the weighted average number of common shares outstanding during the year. Fully diluted earnings per share are calculated on the basis of the weighted average number of shares that would have been outstanding during the year had all stock options been exercised at the date of their issuance.

2. Property, Plant and Equipment

	1995		
	Cost \$	Accumulated depletion and depreciation \$	Net \$
Petroleum and natural gas properties	1,857,807	1,222,497	635,310
Furniture and fixtures	10,813	4,449	6,364
	<u>1,868,620</u>	<u>1,226,946</u>	<u>641,674</u>
	1994		
	Cost \$	Accumulated depletion and depreciation \$	Net \$
Petroleum and natural gas properties	1,420,736	377,138	1,043,598
Furniture and fixtures	10,693	2,888	7,805
	<u>1,431,429</u>	<u>380,026</u>	<u>1,051,403</u>

No interest or general and administrative expenses were capitalized during the period.

Undeveloped property costs of \$111,998 (1994 - \$416,000) have been excluded from capitalized costs subject to depletion.

During the year, the company wrote down its oil and gas assets by \$783,500. This writedown is reflected as additional depletion and depreciation. The ceiling test was calculated using \$1.5856 per MCF representing the average gas price received by the company during the period from January to March, 1996. Had the ceiling test been calculated using the December 31 year-end gas price of the company of \$1.08 per MCF, the ceiling test writedown would have been \$1,108,600.

Petro-Reef Resources Ltd.

Notes to Financial Statements

For the Years Ended December 31, 1995 and 1994

3. Share Capital

The authorized share capital of the company is comprised of an unlimited number of preferred shares and an unlimited number of common shares. Details of the changes in the company's capitalization during 1995 and 1994 are as follows:

	#	\$
Common shares		
Balance at December 31, 1993 as previously recorded	10,495,992	1,448,322
Correction of prior period error (note 7)	-	(10,000)
Balance at December 31, 1993 as restated	10,495,992	1,438,322
Private placement offering, net of issuance cost	435,502	574,738
Issued pursuant to stock options being exercised	100,000	10,000
Balance at December 31, 1994	11,031,494	2,023,060
Issued pursuant to stock options being exercised	200,000	20,000
Issuance costs	-	(494)
Balance at December 31, 1995	11,231,494	2,042,566

At December 31, 1995, 500,000 stock options (1994 - 600,000) were outstanding with exercise prices ranging from \$0.10 to \$0.43 per common share (1994 - \$0.10 to \$1.17 per common share). The options expire after a maximum exercise period of three years from the date of issuance. During the year, the company granted stock options to an officer of the company to purchase 100,000 common shares at an exercise price of \$0.33 per common share. During the year, 200,000 of these options were exercised at an exercise price of \$0.10 per common share.

During 1994, the company issued 435,502 units at \$1.50 per unit for total consideration of \$653,253. Each unit consisted of one common share and a warrant to acquire one common share at an exercise price of \$2.00 per share until September 15, 1995. During 1995, the exercise price of the warrants was reduced to \$0.50 and the exercise period extended to September 15, 1996. During the year, no warrants were exercised.

Subsequent to the year-end, the company reduced the exercise price of all stock options with an original exercise price over \$0.25, amounting to 450,000 shares, to \$0.25.

Petro-Reef Resources Ltd.
Notes to Financial Statements
For the Years Ended December 31, 1995 and 1994

4. Income Taxes

At December 31, 1995, the company had approximately \$1,786,000 (1994 - \$1,514,000) of tax pools available for deduction from future taxable income of which \$427,007 (1994 - \$427,007) are successor pools. In addition, the company has non-capital tax losses of approximately \$311,000, the benefit from which has not been reflected in these financial statements due to a lack of virtual certainty of realizing the tax benefit. These losses expire as follows:

<u>Expiry Date</u>	<u>Amount \$</u>
1996	10,000
1997	5,000
1998	80,000
2000	24,000
2001	9,000
2002	183,000
	<u>311,000</u>

The income tax provision differs from the amount computed by applying the expected income tax rate of 44.58% to earnings before taxes. The reasons for this difference are as follows:

	<u>1995</u>		<u>1994</u>	
	<u>\$</u>	<u>%</u>	<u>\$</u>	<u>%</u>
Loss before taxes	(936,588)		(9,996)	
Expected tax expense at combined federal and provincial rates	(417,531)	(44.6)	(4,432)	(44.3)
Crown royalties and production taxes	1,531	0.1	7,010	70.1
Alberta royalty tax credit	(1,129)	(0.1)	(5,366)	(53.4)
Resource allowance	-	-	(523)	(5.2)
Crown lease rentals	(31,918)	(3.3)	(1,223)	(12.2)
Other	71	-	137	1.4
Benefit not recognized	448,976	47.9	4,397	43.6
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

Petro-Reef Resources Ltd.

Notes to Financial Statements

For the Years Ended December 31, 1995 and 1994

5. Related Party Transactions

Amounts due to directors of the company and companies controlled by directors of the company amount to \$24,037 (1994 - nil).

In 1994, the company paid consulting and finder's fees to a company controlled by a director of the company. No such amounts were paid in 1995.

Management of the company provide their services to the company for no remuneration.

6. Commitments

Future lease payments over the next four years under the company's office lease are as follows:

	\$
1996	10,606
1997	12,120
1998	9,090
	31,816

7. Correction of Prior Year Error

In 1993, pursuant to a management and administrative services agreement, the company issued 200,000 common shares to management which were recorded at \$20,000. During the current year, it was determined that these shares should have been recorded at \$10,000. As a result, the financial statements of the prior periods have been restated and the deficit previously recorded at January 1, 1994, and the value of share capital at that date, have been reduced by \$10,000 accordingly.